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SUBJECT: ARMENIAN ECONOMIC GROWTH REMAINS STRONG

REFS: A)YEREVAN 150 B)YEREVAN 364 C)YEREVAN 174

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SUMMARY

¶1. (SBU) Armenia's GDP grew by eight percent during the first quarter of 2006, continuing a trend of impressive, often double-digit, growth rates over the past few years. Construction remained the primary driver of growth, up 25.2 percent compared to the first quarter of 2005. Retail trade was the second largest contributor, up 13.6 percent. Inflation for the first quarter was 4.2 percent due primarily to higher food prices. (Note: Although April 1 fuel price increases were anticipated during the first quarter, they were not a factor in first quarter inflation figures. End Note.) Overall exports fell by 5.6 percent, largely as a result of a 39.4 percent decline in diamond production. Imports only grew by 13.6 percent (a significant decline from 2005's 30.9 percent growth rate). Tax revenues rose 16.2 percent, marked by a 73 percent increase in the collection of corporate taxes. End Summary.

CONSTRUCTION CONTINUES TO DRIVE ECONOMIC GROWTH

¶2. (SBU) The Armenian GDP grew by eight percent for the first quarter of 2006 (reaching USD 590.2 million). As in previous years, construction was the primary driver of growth (up 25.2 percent compared to the first quarter of 2005). According to Armenia's National Statistical Service, construction volume in the first quarter of 2006 was USD 61.8 million, with private financing accounting for 91.7 percent of the growth in the sector. Forty-five percent of total construction was residential. Retail trade (up 13.6 percent) and agriculture (up 3.5 percent) were the second and third largest contributors to GDP growth.

INDUSTRIAL OUTPUT DOWN BY 4.7 PERCENT

¶3. (SBU) Industrial output declined 4.7 percent, mainly due to a sharp decrease in diamond production

(down 39.4 percent). Head of the Precious Stones and Jewelry Department at the Ministry of Trade and Economic Development Gagik Mkrtchyan attributed the decline to an alleged theft at Armenia's major diamond cutting factory, Shoghakn CJSC, which caused a ten-day work stoppage. Non-diamond industrial production grew by 1.1 percent, mainly due to increased output from food and beverage industries (up 13.6 percent) and metallurgy (up 5.7 percent). Energy production, which accounts for 23 percent of industrial output also dropped by 6.3 percent following a ten-day cut in natural supplies from Russia (ref A).

INCREASED INFLATION LIKELY

14. (SBU) The inflation rate at the end of the first quarter of 2006 was 4.2 percent against December 2005. Higher prices for food, including fish (up 42.4 percent from December 2005), fruits and vegetables (up 37.2 percent) and sugar (up 7.2 percent) fueled the increase. (Note: Inflation will likely continue to rise in the coming months as a result of increased natural gas prices (ref B) and a planned 38 percent increase in water tariffs. The April 1 fuel price increases were not a factor in first quarter inflation figures, however. End Note.)

IMPORTS GROW, EXPORTS DECLINE

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15. (SBU) Foreign trade turnover grew at a moderate pace of 7.0 percent in the first quarter of 2006. Exports declined 5.6 percent to USD 184.4 million and imports grew 13.6 percent to USD 422 million. Diamond exports, which in 2005 accounted for 30 percent of the overall exports, declined by 36 percent in the first quarter of 2006. As a result, the first quarter trade deficit as a share of GDP grew from 34 percent in 2005 to 40.3 percent in 2006. Non-diamond exports totaled USD 138.1 million, up 2.7 percent. Non-diamond imports totaled USD 368 million (up 25.6 percent) with significant increases in imports from CIS countries (up 39.3 percent) and Iran (up 38.3 percent). Exports to the U.S. grew 25.8 percent to USD 11.9 million. Imports from the U.S. increased 37.5 percent to USD 28.5 million.

CORPORATE TAX COLLECTION UP 73 PERCENT

16. (SBU) Budget revenues were USD 182.1 million and expenditures were USD 189.2 million, up 6 percent and 24.9 percent, respectively. Tax revenues (USD 157.2 million) and state duties (USD 8.2 million) grew 16.2 percent, accounting for 28 percent of GDP (up from 26 percent in the first quarter of 2005). Collection of direct taxes increased significantly with corporate tax payments up 73 percent and income tax payments up 46.4 percent. Despite the increase, direct taxes only accounted for 25.7 percent of total revenues. Indirect taxes (VAT and excise tax) accounted for more than half of revenue at 54.8 percent, down from 61.2 percent in the first quarter of 2005. According to the State Tax Services' list of the 300 largest taxpayers (published on April 22), many large companies made payments for the first time this quarter. Education and health expenditures were up 29.1 percent and 49.7 percent,

respectively. Expenditure in education accounted for 4.8 percent of GDP (up from 4 percent in 2005), and health expenditures were 2.4 percent of GDP (up from 1.7 percent in 2005).

COMMENT:

17. (SBU) Construction growth is likely to remain strong throughout the spring and summer and continue to support impressive overall growth rates. In addition to an increase in privately funded projects, we expect large infrastructure projects funded by the Lincy Foundation (ref C) and Millennium Challenge Corporation will spur additional growth in this sector. Armenia's economy remains, however, relatively small and lacks diversity. The negative impact on Armenia's trade deficit of a ten-day work stoppage at a single diamond factory highlights Armenia's continued vulnerability to economic shocks.

EVANS